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INTRODUCTION

In accordance with the City Auditor's 1991-92 Audit Workplan, we have reviewed the General Services Department/Purchasing Division's formal bidding process. We conducted this audit in accordance with generally accepted government auditing standards and limited our work to those areas specified in the Scope and Methodology section of this report.

BACKGROUND

The San Jose City Charter and Municipal Code specify the City's purchasing requirements. Implicit in the Charter and the Code are the goals of competition, fairness, economy, and openness. These goals are in keeping with authoritative standards of government purchasing. *"Briefly translated, they mean that public business is to be offered for competition; that bidders are to be treated alike and contracts administered alike, without favoritism; that economy and value are basic aims; and that documents used and actions taken are public information."*¹

To achieve its purchasing goals, the Municipal Code prescribes competitive bidding as the City's primary method of procurement for purchases of materials, supplies, and equipment exceeding \$20,000. This audit focuses on the competitive sealed bidding process (also referred to as "formal bidding") for supplies, material, and equipment costing more than \$20,000.

The Model Competitive Sealed Bidding Process

The essential components of a competitive sealed bidding process as described in the Model Procurement Code for State and Local Governments by the American Bar Association are the following:

1. *Invitation For Bids*. This document initiates the competitive sealed bidding process. The Invitation for Bids (IFB) should include the purchase description and all contractual terms and conditions applicable to the procurement, including the evaluation criteria for the selection of the winning bid.

¹ The Council of State Governments and The National Association of State Purchasing Officials, State and Local Government Purchasing, 3rd ed., 1988, page 7.

2. *Public Notice*. The public entity should provide adequate public notice of the IFB with a reasonable time prior to bid opening. Such notice may include publication in a newspaper of general circulation.
3. *Bid Opening*. The public entity should open the bids publicly at a designated time and place in the presence of one or more witnesses. The purchasing staff should record the amount of each bid, the name of the bidder, and other relevant information. The records and each bid should be open to public inspection.
4. *Bid Acceptance and Bid Evaluation*. The public entity should unconditionally accept the bids without alteration or correction except as authorized by regulations. The purchasing staff should evaluate the bids based on criteria set forth in the IFB to determine acceptability. The bids should meet the criteria for activities and goals, such as: inspection, testing, quality, workmanship, delivery, and suitability for a particular purpose. The staff may not use criteria that are not set forth in the IFB.
5. *Correction or Withdrawal of Bids and Cancellation of Awards*. Written regulations should govern the correction or withdrawal of inadvertently erroneous bids before or after an award and the cancellation of awards or contracts based on such bid mistakes. After bid opening, the purchasing staff should not permit any changes in bid prices or other provisions of bids that are contrary to the interest of the public entity.
6. *Award*. The purchasing staff should award the contract with reasonable promptness by written notice to the lowest responsible and responsive bidder whose bid meets the requirements and criteria set forth in the IFB.

The City's Formal Bidding Process

Appendix B shows the flowchart of the City's formal bidding process. In general, the Director of General Services is responsible for administering formal bidding in the City for equipment, supplies, and materials. The City departments, however, also play important roles in the bidding process. The process starts when, based on its approved budget, the requesting department prepares the requisition. The Purchasing Division (Purchasing) of the General Services Department processes

the requisition. With input from Purchasing, the requisitioning department prepares the technical specifications, and Purchasing prepares the bid invitation, including the purchase specifications.² Purchasing then develops the list of vendors, which includes vendors the requisitioning department suggests.

When Purchasing completes the purchase specifications and the list of vendors, it sends out the bid invitations. The City Clerk also advertises the bid invitation at least ten calendar days prior to bid opening. Purchasing supervises the bid opening and records the bids. The requesting department and the Purchasing staff evaluate the bid submittals and, based on criteria set forth in the specifications, recommend selection of the vendor. The General Services Department reports the results of the bidding to the City Council and requests approval for the purchase.

Program Accomplishments

In Appendix I, the General Services Department informs us of its major accomplishments in the administration of the formal bidding process.

According to the Director of General Services, the department completed the following accomplishments:

1. Purchasing has never had a written procedure for processing formal bids. As of April 1, 1991, an internal procedures manual for Purchasing was completed which includes policies and procedures for all aspects of the formal bidding process.
2. Purchasing has a strong commitment to ensure that minority vendors are afforded an opportunity to bid on City projects. As a result, all formal bids are sent to the various minority Chambers of Commerce in the City.

² If the procurement is a vehicle purchase, the Vehicle Maintenance Division of the Department of General Services prepares the specifications. The Fire Department, however, writes its own specifications for the purchase of fire suppression vehicles.

3. There has never been a systematic process to inform vendors of the outcome of formal bids. Purchasing is now informing vendors of the recommended award and the City Council hearing date by sending copies of the approved Council memorandum to all vendors who bid on a project.

SCOPE AND METHODOLOGY

We reviewed the formal bidding process the General Services Department/Purchasing Division (Purchasing) administers to assess internal controls over the formal bidding process for compliance with applicable rules and regulations, including the Municipal Code and authoritative government purchasing standards and practices. These authoritative standards include those of the Council of State Governments and the Council of Urban, State and Local Government Law of the American Bar Association.

Based on 1990 San Jose City Council meeting synopses, we listed the formal bids the City Council approved. We focused our audit on formally bid purchase orders. The Municipal Code does not require that open purchase orders be formally bid; however, the City formally bids some open purchase orders, so we included two formally bid open purchase orders in our audit sample. The list we compiled contained 39 formal bids with a total dollar amount of \$4,608,073. We selected an audit sample from this list. We chose all formal bids exceeding \$100,000 and three formal bids under \$100,000. Our audit sample represents 75.2 percent of the dollar amount of formal bids on the list. Appendix C summarizes the formal bids we reviewed.

Our audit included a review of the procedures of the General Services Department relating to formal bid purchases. We interviewed staff, observed bid openings, and reviewed bidding documents from Purchasing, Vehicle Maintenance Division, the Department of Convention and Cultural Facilities, the Fire Department, Risk Management, the Office of Affirmative Action and Contract Compliance, and the City Attorney's Office.

In the course of our audit, we noted several areas that were outside of the scope of this audit but that may have efficiency and effectiveness implications for the City's bidding process and should be considered for future audits. These areas are:

1. Non-low bid awards. In the course of the audit, we noted a significant number of awards made to vendors that did not bid the lowest price.
2. A bidding matrix for large repetitive purchases. Developing a bidding matrix for a particular commodity documents procurement trends. We initiated a bidding matrix during this audit but found it difficult to select similar commodity purchases year after year. A bidding matrix could be better utilized when auditing open purchase orders.
3. Open purchase order formal bids. Municipal Code Section 4.12.146.D states, "*Formal bidding is not required in order to establish an open purchase order for supplies, materials or equipment regardless of its total dollar amount.*" However, the City does formally bid some open purchase orders. Only two open purchase orders were included in our audit sample for this audit. Since major repetitive type purchases are made through the open purchase order process this could be an area for further review.
4. The Financial Management System (FMS) on-line requisition system. Purchasing relies on the integrity of the FMS on-line requisition system. This system has matured to the point where an audit seems appropriate.
5. Purchasing volume activity. Reviewing and analyzing purchasing activity by purchase orders processed, commodity type, procurement method, and buyer could be used to identify purchasing trends, resource usage, and workload statistics.
6. Commonly used vendors. This area could be analyzed to determine if there is adequate competition for certain commodity purchases.

FINDING I

ADDITIONAL PROCEDURES ARE NEEDED TO ENHANCE COMPLIANCE WITH FORMAL BIDDING REQUIREMENTS OF THE CITY COUNCIL, CITY CODE, ADMINISTRATION, AND AUTHORITATIVE SOURCES

City Council Resolution No. 62248 authorized the City Manager or his designee to execute various purchase orders and agreements of more than \$20,000 that were essential to City operations from June 27, 1990, through August 13, 1990. The City Manager was to report such purchase orders and agreements to the City Council during August 1990 or in the City Manager's quarterly report to the Council for the fourth quarter of fiscal year 1989-90 or the first quarter of fiscal year 1990-91. Our review revealed five formal bids that should have been reported in accordance with Resolution No. 62248 but were not. In addition, Municipal Code Section 4.84.020 prescribes the conditions under which persons (including vendors) using or occupying City-owned real property are required to obtain insurance. During our audit we identified two instances when vendors should have had proof of insurance on file with the City but did not. We also noted that the City did not monitor the receipt of the affirmative action plans for any of the 13 awarded bids we reviewed to verify vendor compliance with the City's nondiscrimination and affirmative action policies. Further, we noted two instances when Purchasing's written procedures or bid package specification requirements regarding vendor performance bonds were not followed. Finally, we noted two instances when City departments approved additional work without going through Purchasing or obtaining prior City Council approval. By implementing additional procedures, the City can enhance its compliance with formal bidding requirements and reduce the City's exposure to legal

and financial liability, vendor nonperformance, noncompliance with nondiscrimination and affirmative action policies, and the performance of unauthorized work.

Noncompliance With City Council Resolution No. 62248

The Municipal Code requires City Council's approval for purchase orders and agreements of more than \$20,000. However, when the City Council is not in session, the Council delegates this approval authority to the City Manager or his designee. Accordingly, City Council Resolution No. 62248 authorized the City Manager or his designee to execute purchase orders and agreements of more than \$20,000 while the City Council was not in session from June 27, 1990, through August 13, 1990. The City Manager was to report such purchase orders and agreements to the City Council during August 1990 or in the City Manager's report to the City Council for the fourth quarter of fiscal year 1989-90 or the first quarter of fiscal year 1990-91. As of the end of fiscal year 1990-91, however, the City Manager had not yet submitted the fiscal year 1989-90 report to the City Council in accordance with Resolution No. 62248. When we inquired about the list, Purchasing had prepared the list of formal bids to be submitted to the City Council; however, our review revealed that Purchasing did not include the following five formal bids on the list.

Purchase Order		Vendor	Description	Amount
Date	Number			
06/25/90	25833	Mission Valley Ford	Cab and chassis	\$45,437.54
06/30/90	26080	Apple Computer	Computer equipment	34,159.99
06/30/90	26084	Case Power	Tractor loader	23,257.46
06/30/90	26086	Wolf Computer	Computer equipment	30,555.72
07/11/90	26048	Mission Valley Ford	Cab and chassis with dump	45,746.42

Our review indicated that the omission of the five formal bids was not intentional. Purchasing maintains a file of purchase orders greater than \$20,000 for the quarterly report. Purchasing uses this file in preparing the list of City Manager-approved purchase orders greater than \$20,000. However, Purchasing inadvertently left out the five formal bids in the list that the City Manager was to submit to the City Council for ratification. After we informed Purchasing of the oversight, Purchasing included the five purchase orders in the report to the City Council. On July 11, 1991, the General Services Department submitted the list of City Manager-approved purchase orders greater than \$20,000 to the City Council. The list included the five purchase orders that were originally left out.

In the future, Purchasing should (1) promptly submit to the City Council the quarterly report of purchase orders and agreements of more than \$20,000 that the City Manager or his designee executed and (2) establish a review process to ensure that all purchase orders that should be reported to the City Council are included in the report.

Required Proofs Of Insurance Not On File

The Municipal Code requires persons using or occupying City-owned real property to obtain insurance coverage. Municipal Code Section 4.84.020 states:

Unless otherwise provided by ordinance, resolution or other action of the city council, each person occupying or using any real property of the city and/or structures or improvements thereon pursuant to a license, permit, lease, concession, or other agreement or contract shall, at his sole cost and expense, obtain, pay for and maintain during the full term of his use or occupancy of such property and/or structures or improvements thereon the following insurance, including endorsements thereto.

The policy or policies shall provide insurance covering each such person with respect to all use or occupancy of any city-owned real property, structures or improvements thereon on a comprehensive basis and provide fire legal liability coverage. The bodily injury liability, property damage liability, and fire legal liability coverages shall all be on an “occurrence basis.”

The required insurances shall consist of the following minimum types of coverages:

- A. Owners, landlords and tenants coverage with a minimum limit of five hundred thousand dollars combined single limit.*
- B. Fire legal liability with a minimum limit of one hundred thousand dollars per occurrence.*

Our review disclosed two instances when vendors should have had proof of insurance on file with the City but did not. The two instances were (1) the June 1990 formal bid of seal coat aggregate in the amount of \$409,354 and (2) the November 1990 formal bid of the Convention Center readerboard in the amount of \$119,833.

In the June 1990 formal bid of seal coat aggregate, the original bid specifications had not required insurance, although the work included transportation of the product on City property. The insurance analyst in the City’s Risk Management insurance section confirmed that this type of transaction qualified under Municipal Code Section 4.84.020 and that the bid specifications or the purchase order should have required the vendor to provide appropriate insurance. We noted that the insurance requirements were included in the April 1991 bid invitation for the seal coat aggregate solicitation. In the November 1990 formal bid of the Convention Center readerboard, the bid specifications had required the insurance; however, neither Purchasing nor Risk Management’s insurance section had evidence of the insurance on file.

The City has established procedures for the review and approval of insurance coverage. City purchasing procedures state that after Purchasing has established the insurance requirements, Purchasing should prepare Form 149-7 (Notification of Contract or Agreement Being Processed). Purchasing then forwards the completed form, together with a copy of the requisition and insurance requirements, to the Risk Manager, who reviews the insurance documents and approves the coverage. The Risk Manager then returns Form 149-7 to Purchasing, indicating that the Risk Manager has approved the insurance coverage.

In the two instances disclosed by our review, Purchasing did not follow the established procedures. Purchasing staff overlooked the insurance requirements and, thus, did not require the vendor to furnish the insurance documentation. Therefore, in instances in which vendors must use or occupy City-owned real property in performing the tasks for which they contracted with the City, the vendors must provide this proof of insurance.

So that Purchasing can ascertain that transactions requiring insurance coverage are not overlooked, Purchasing should develop a checklist for the various requirements for formal bids. The checklist should include the requirements for insurance, bonding, specifications, and evaluation and award review. The person responsible for ascertaining the requirements should sign and date the checklist. The Purchasing Manager or his/her designee should also review, sign, and date this checklist. Purchasing should follow its procedure to ensure that evidence of insurance is obtained.

During our audit, we noted that Risk Management has set the following minimum insurance requirements for all vendors doing business with the City regardless of the dollar amount of the purchase:

1. Comprehensive General Liability: \$1,000,000 combined single limit per occurrence for bodily injury, personal injury, and property damage.
2. Automobile Liability: \$1,000,000 combined single limit per accident for bodily injury and property damage.
3. Workers' Compensation and Employers Liability: Workers' Compensation limits as required by the Labor Code of the State of California and Employers Liability limits of \$100,000 per accident.

According to Purchasing, the above insurance requirements would limit small businesses and women- and minority-owned businesses from participating in City procurements. Further, these insurance requirements also increase the cost of the product to the City since the bidder includes the cost of the insurance in their bid price.

According to the insurance analyst in Risk Management's insurance section, the State of California requires worker's compensation on all businesses that have employees and the above insurance requirements are industry standards. Further, small businesses that work with contractors or lease office space would require this level of insurance. These insurance requirements protect the City in today's business environment and are "a cost of doing business" for vendors.

In our opinion, the City administration and the City Council need to address the City's policy on insurance requirements. The General Services Department/Purchasing Division and the Risk Management's insurance section

should report to the Finance Committee on any suggested changes to the City's insurance policy and the impact any policy changes would have on small businesses and women- and minority-owned businesses.

**Inadequate Monitoring Of Compliance
With Nondiscrimination And Affirmative Action Policies**

The Municipal Code requires contractors to document compliance with the City's nondiscrimination and affirmative action policies. Municipal Code Section 4.08.080 states the following requirements:

1. *a. Prior to the award of a purchasing contract pursuant to sealed bids, requiring city to pay the contractor a sum in excess of fifty thousand dollars (or if the amount of such payment is not fixed, but is estimated by city to exceed fifty thousand dollars), the apparent low bidder, within a time specified in the contract documents, shall attend an affirmative action conference with the city manager to review and discuss with the city manager the proposed affirmative action programs of such contractor.*
- b. Within fifteen days after such conference, or within such other time as may be specified in the contract documents, the contractor shall submit to the city manager three copies of his written affirmative action programs complying with the requirements of Section 4.08.050 and with the affirmative action guidelines for purchasing contracts adopted by the city council.*
- c. The city manager shall review the affirmative action program of such contractor and any modifications thereto to determine whether it complies with the requirements of Section 4.08.050 and the affirmative action guidelines for purchasing contracts adopted by the city council. If the city manager determines that said program complies with such requirements, he shall so report to the city council. If the council after consideration of said report is satisfied that said program does comply with said requirements, it may proceed to award the contract to the contractor.*
- d. If the city manager determines that said program does not comply with said requirements, he shall advise the contractor of*

the deficiencies of such program and shall allow the contractor to make necessary modifications thereto and shall fix a time by which such modifications to the program or programs must be submitted by the contractor. If the contractor does not submit the necessary modifications within the time so fixed, or extensions thereof granted by the city manager, the city manager shall file a report with the city council. If the city council determines that the affirmative action program of the contractor does not comply with said requirements, the council shall find that the contractor is not a responsible bidder and reject his bid. The council may grant additional time to any contractor to submit a satisfactory program. If the council finds that the written program does comply with said requirements, the council may award the contract to such contractor.

Our review indicated that neither Purchasing nor the Office of Affirmative Action and Contract Compliance monitors vendor compliance with the City's nondiscrimination and affirmative action guidelines. We found that Purchasing does not ascertain that the City receives affirmative action plans from awarded bidders. Further, when we contacted the Office of Affirmative Action and Contract Compliance, we learned that the Office did not review the affirmative action programs on purchases that Purchasing administers.

Additionally, Purchasing's bid invitation documents include a Vendor Workforce Ethnic Composition Analysis form and instructions that require the vendors to provide the City with information regarding their workforce ethnic composition. In 4 of the 13 purchasing contracts we reviewed, we did not find completed Vendor Workforce Ethnic Composition Analysis forms in the bid files. The following are the four purchasing contracts:

Council Approval Date	<u>Vendor</u>	<u>Description</u>	<u>Amount</u>
03/20/90	Worthington Chevrolet	Police sedans	\$1,623,231
05/29/90	Mission Valley Ford	Pickup trucks	103,181
06/12/90	Mission Valley Ford	Cab and chassis	115,953
10/30/90	Mission Valley Ford	Rescue cab and chassis	164,599

The purpose of the Vendor Workforce Ethnic Composition Analysis and the vendor's written affirmative action program is to provide the City administration additional information to assist in determining whether the vendor meets the City's nondiscrimination and affirmative action guidelines. Purchasing includes this form in the bid invitation and requires the vendor to complete and return it with the bid. In our opinion, Purchasing should establish procedures to ensure that contractors provide the required documentation to enable the City to determine vendor compliance with the City's nondiscrimination and affirmative action policies. Further, the Office of Affirmative Action and Contract Compliance should review the Vendor Workforce Ethnic Composition Analysis and the vendor's written affirmative action plan to determine vendor compliance with the City's guidelines and report to the City Council on vendor compliance in accordance with the Municipal Code.

Noncompliance With Performance Bond Requirements

Performance bonds protect the City against bad faith or failure on the part of bidders and contractors. The State and Local Government Purchasing manual describes the protection provided by performance bonds:

Requiring bonds as a part of the bidding and award process, and as applicable until completion of a contract, is intended as protection for the taxpayer against bad faith or failure on the part of bidders and contractors. ...

Performance bonds are invariably required for public works contracts and not infrequently on contracts for equipment and services. The bonds are furnished by a properly licensed surety company and provide for fulfillment of the contract obligations by others in the event of default by the successful bidder. As with payment bonds, the amount of a performance bond is usually 100 percent of the amount of the contract and may be reduced proportionately as performance under the contract moves forward successfully.³

Our audit disclosed two instances in which the City did not follow bid specification requirements or established Purchasing procedures regarding vendor performance bonds. The two instances were (1) the February 1990 purchase of an articulated frame earth compactor for \$187,634 from Peterson Tractor Company and (2) the October 1990 purchase of four rescue cabs and chassis for \$164,591 from Mission Valley Ford.

In the purchase of the articulated frame earth compactor, the purchase specifications state the following:

The successful bidder will be required to furnish a performance bond or other binding legal document that will guarantee one hundred percent of the amount of the repurchase price in favor of the City of San Jose to protect the City of San Jose against any breach of contract.

The bond will remain in effect for the five (5) year contract period. It is understood and agreed by the bidder that should his bid be accepted and award be made to him and bidder fails or refuses to furnish the performance bond within ten days after receiving notice from the Purchaser to file such bond, the Purchaser may, at his option, determine that this bidder has abandoned the bid and may accept the bid of and award the contract to the next low

³ State and Local Government Purchasing, 3rd ed., page 56.

bidder. Thereupon, the award of said contract to this bidder shall be null and void.

The successful bidder shall make arrangements for this bond to continue in full force and effect for the duration of the "guaranteed maintenance" period specified herein.

Our review disclosed that the vendor of the articulated frame earth compactor did not provide the required performance bond. It should be noted that after we advised Purchasing of this matter, Purchasing contacted the vendor and obtained a notarized letter from the vendor, stating: *"Peterson Tractor Co. guarantees a minimum repurchase price on the above referenced equipment of \$90,000.00, on or before March 30, 1995, assuming the equipment has been used in normal application, and the condition of the equipment is the same as when delivered, less normal wear and tear."* However, this guarantee is not the equivalent of the 100 percent performance bond called for in the specifications.

In the purchase of the four rescue cabs and chassis, the specifications did not require a performance bond. However, the City's Purchasing Administrative Manual does require the buyer, when working on procurement requests over \$50,000, to prepare a memorandum to the Risk Manager requesting a determination of whether a performance bond is required. No such memorandum or Risk Manager determination was on file for the \$164,591 purchase of the four rescue cabs and chassis.

According to Purchasing management, Purchasing's procedure regarding the Risk Manager's determination of performance bond requirements is not workable. According to the insurance analyst within Risk Management's insurance section, the City has not had a Risk Manager for nearly a year and the two current Risk Management insurance section employees (a Staff Technician and an Insurance

Analyst) do not have the expertise required to determine if a performance bond is needed or what amount the bond should be.

In our opinion, Purchasing should modify its procedures to obtain from the City's Risk Manager a written determination regarding the need for and the amount of any performance bonds required. If the City's Risk Manager is not willing or able to make such a determination, Purchasing should use an independent contractor to determine the need for and the amount of any performance bonds required. Furthermore, Purchasing should ensure that the vendor promptly provides any performance bond that the purchase specifications or department procedures may require.

**Departments Authorized Additional Work
Without Purchasing Review Or City Council Approval**

Our audit disclosed two contracts in which the department authorized additional work without notifying Purchasing or obtaining prior approval from the City Council. The two contracts were (1) the \$119,833 purchase of an electronic readerboard from Daktronics for the Department of Convention and Cultural Facilities and (2) the \$321,455 purchase of a hazardous materials van from John F. Russo, Inc., for the Fire Department.

The additional work on the electronic readerboard contract was for design changes to the sign mounting, which cost an additional \$9,486. A representative of the Department of Convention and Cultural Facilities authorized the change on February 19, 1991. Purchasing submitted the contract change to the City Council for retroactive approval in May 1991. According to the Purchasing staff, the Department

of Convention and Cultural Facilities did not submit a purchase requisition to inform Purchasing of the additional work before authorizing the work.

The additional work on the contract for the hazardous materials van was for vehicle modifications to replace cloth awnings with metal awnings, which cost an additional \$14,980. A representative of the Fire Department authorized the change, and the Fire Department prepared the documentation “after the fact” on March 28, 1991. Purchasing submitted the contract change to the City Council for retroactive approval in April 1991. According to the Purchasing staff, the Fire Department did not notify Purchasing before approving the additional work.

The City Charter and the Municipal Code assigns functional responsibility for the procurement of all supplies, materials, equipment, and general services to the Director of General Services. This responsibility is delegated to the Purchasing Manager. The City Administrative Manual Section 202.2 states that

No department head, officer, or employee other than the City Manager, City Attorney, City Clerk, City Auditor, Director of General Services, or the Chief of Purchasing may (1) bind the City for the purchase of any materials, supplies, equipment or services, or (2) negotiate with any vendor regarding the procurement or to procure any of the items cited above except under the following circumstances:

A. A department head may make certain purchases when goods or service are urgently needed for the preservation of life, health or property and it is impossible to contact the Chief of Purchasing within the time available.

B. The Director of Public Works may make certain contractual agreements for the completion or maintenance of Public Works projects, Miscellaneous Public Works projects, and other projects described in the Municipal Code where acquisition of materials, services, or equipment is incidental to the contractual agreement and in conformance with the provisions prescribed in Title 14,

Chapter 14.04, Sections 14.04.010 thru 14.04.141, of the San Jose Municipal Code.

Purchases of supplies, materials, equipment or services without a properly authorized procurement document such as a purchase order or voucher issued by the Chief of Purchasing or a formal written agreement signed by the City Manager, is UNAUTHORIZED. Individuals making such purchases shall be held responsible for payment.

In our opinion, Purchasing should establish procedures for ensuring that City departments do not bind the City for the purchase of any unauthorized materials, supplies, equipment, or services or negotiate with vendors regarding procurements.

CONCLUSION

Our review of the General Services Department/Purchasing Division's formal bidding process revealed that additional procedures are needed to enhance compliance with the Municipal Code and administrative procedures. Our review disclosed that Purchasing did not report promptly to the City Council the purchase orders and agreements of more than \$20,000 the City Manager approved during the Council's absence. In addition, neither Purchasing nor Risk Management's insurance section had on file the proofs of insurance required on two contracts. We also noted that neither Purchasing nor the Office of Affirmative Action and Contract Compliance is monitoring the receipt of affirmative action plans for awarded bidders on purchasing contracts to verify vendor compliance with the City's nondiscrimination and affirmative action policies. Further, we noted two instances when Purchasing's written procedures or bid package specification requirements regarding vendor performance bonds were not followed. Finally, we noted two instances when City departments approved additional work without going through Purchasing or obtaining prior City Council approval. By implementing additional

procedures, the City can enhance its compliance with formal bidding requirements and reduce the City's exposure to legal and financial liability, vendor nonperformance, noncompliance with nondiscrimination and affirmative action policies, and the performance of unauthorized work.

RECOMMENDATIONS

We recommend that General Services Department/Purchasing Division take the following actions:

Recommendation #1

Promptly submit to the City Council the quarterly report of purchase orders and agreements of more than \$20,000 that the City Manager or his designee executed in accordance with City Council requirements. (Priority 2)

Recommendation #2

Establish a review process to ensure that all purchase orders and agreements it should report to the City Council are included in the report. (Priority 2)

Recommendation #3

Develop a checklist for the review of various requirements for formal bids, including insurance, bonding, specifications, and evaluation and award. The person responsible for ascertaining the requirements, as well as the person performing the supervisory review, should sign and date the checklist.
(Priority 2)

We also recommend that the General Services Department/Purchasing Division and Risk Management's insurance section:

Recommendation #4:

Report to the Finance Committee on any suggested changes to the City's insurance policy and the impact any policy changes have on small businesses and women- and minority-owned businesses so that the City administration and the City Council can address the City's policy on insurance requirements. (Priority 2)

Recommendation #5

Establish procedures to ensure that contractors provide the required documentation to enable the City to determine vendor compliance with the City's nondiscrimination and affirmative action policies. (Priority 3)

In addition, we recommend that the Office of Affirmative Action and Contract Compliance:

Recommendation #6

Review the Vendor Workforce Ethnic Composition Analysis and the vendor's written affirmative action plan, determine vendor compliance with the City's nondiscrimination and affirmative action guidelines, and report to the City Council on vendor compliance in accordance with the Municipal Code. (Priority 3)

Further, we recommend that the General Services Department/Purchasing Division:

Recommendation #7

Obtain from the City's Risk Manager or an independent contractor a written determination regarding the need for and amount of any performance bonds and ensure that the vendor promptly provides any performance bond that the purchase specifications or department procedures may require. (Priority 2)

Recommendation #8

Establish procedures for ensuring that City departments do not bind the City for the purchase of any unauthorized materials, supplies, equipment, or services or negotiate with vendors regarding procurements. (Priority 2)

Recommendations Requiring Budget Action

Of the preceding Recommendations, #7 cannot be implemented absent additional funding. Accordingly, subject to City Council approval of these Recommendations, the City Manager should include in the City Manager's Proposed Operating Budget for 1992-93 an amount sufficient to implement Recommendation #7.

FINDING II

THE CITY OF SAN JOSE CAN IMPROVE ITS FORMAL BIDDING PROCESS

A formal bidding process for state and local governments should be open and fair, encourage competition, and provide the purchasing entity with the best product at the lowest possible price. Our review revealed that the City of San Jose can improve its formal bidding process. Specifically, we noted the following:

- City departments can prepare bid specifications that are too restrictive;
- City departments have too much discretion in adding or deleting bid options to determine the low bidder;
- City departments can evaluate bids on the basis of criteria not spelled out in the bid specifications;
- The City has not established a formal bidders list and is not monitoring the vendors' performance after it awards them bids;
- Some bid tabulation sheets are incomplete or unverified;
- Additional written procedures and guidelines are needed to lend consistency to the City's formal bidding process;
- The City's formal bidding process needs additional documentation; and
- The filing of bid documents can be better organized.

By (1) formalizing and standardizing the preparation and evaluation of bid specifications and submittals and vendor solicitations and performance, (2) improving the tabulation of bids, (3) developing additional written procedures and guidelines for formal bidding, (4) improving the documentation of the formal bidding

process, and (5) better organizing formal bid files, the City of San Jose will have greater assurance that its bidding process is open, fair, competitive, and economical.

State And Local Purchasing

A formal bidding process for state and local governments should be open and fair, encourage competition, and provide the purchasing entity with the best product at the lowest possible price. The Council of State Governments in cooperation with the National Association of State Purchasing Officials has published an authoritative book titled State and Local Government Purchasing (SLGP). Additionally, the American Bar Association has also published The Model Procurement Code for State and Local Governments. These books discuss the objectives and challenges of public purchasing and recommend specific policies and practices to achieve these objectives.

To make the bidding process open and fair, SLGP emphasizes the need for high standards in all aspects of purchasing, especially the tasks that are not readily visible to the public. According to SLGP, a public entity's purchasing regulations and bidding announcements will invariably assert or imply that the bidding is open to all prospective vendors and that the public entity will treat all bidders fairly. However, the words "openness" and "fairness" acquire their true meaning not so much in the public announcements as in the less noticeable processes of specifications writing and bid evaluation.

Therefore, according to SLGP, the purchasing staff should write the purchase specifications and the evaluation criteria with the objective of encouraging, rather than discouraging, the participation of interested vendors. The purchase

specifications must reflect the real needs of the public entity rather than serve to limit the bidding to a single product. Further, in its bid evaluation, the purchasing staff should follow strict procedures during bid opening to maintain the essence as well as the expression of fairness. The purchasing entity must also prepare clear and accurate documentation of the bid evaluation to facilitate subsequent review and to support the decision on the bid award should a later dispute arise. Finally, the purchasing entity must not use criteria that it has not set forth in the purchase specifications.

To encourage competition in the bidding process, many public entities rely on the use of public notices. SLGP, however, suggests that the public entity not rely solely on such public notices to generate competition. The notices serve mainly to declare publicly what is being bought or sold and when, how, and where bids can be submitted. According to SLGP, such public notices contribute to the openness of the purchasing process but are “not highly useful in generating competition.”⁴

A public entity can better generate competition by using a “bidders list.” A bidders list (sometimes called a “vendors list”) is a categorized listing of prospective suppliers. In maintaining the bidders list, the purchasing office should constantly seek new suppliers to add to the list and should remove from it those suppliers whose performance is unsatisfactory. With a well-maintained bidders list, the public entity can effectively and efficiently identify prospective suppliers and avoid unproductive and wasteful solicitations.

To provide the purchasing entity with the best product at the lowest possible price, SLGP recommends using purchase specifications that concentrate on value and

⁴ SLGP, page 53.

performance criteria and allow the vendors to compete on the basis of these criteria. SLGP cites the growing popularity of the “functional or performance type of specification.”⁵ The performance specification is “results oriented,” focused on how well a product performs and at what cost, rather than on how it is made. For this reason, the objective under performance purchasing is to invest funds rather than to spend funds.

*Purchasing will be expected, by senior management and by the public at large, to show more demonstrable results. This entails being more cost-conscious and value-oriented. It calls for more evaluation criteria under competitive bidding that take into account qualitative differences in commercial products, ... for devising evaluation factors which measure price and performance relationships to arrive at best value. And it will require focusing on means to achieve reduction and containment of costs. In these ways purchasing will make distinctions between price and cost, will define tangible economy, will provide incentives for sellers to improve product quality, will change its “low-bid” image, and will enable management to recognize good purchasing.*⁶

Restrictive Bid Specifications

The authoritative book on purchasing, SLGP, counsels against the use of restrictive specifications or specifications that contain such detailed design requirements that they effectively limit the purchase to a specific supplier.⁷ The main purpose of a purchase specification is to communicate to prospective vendors the description of the product being sought and to clarify what is suitable or acceptable. Another purpose of a specification is to generate the maximum amount of reasonable competition. It is for the latter purpose that SLGP recommends against the use of restrictive specifications.

⁵ SLGP, page 45.

⁶ SLGP, page 8.

⁷ SLGP, page 44.

By nature, a specification sets limits and thereby eliminates, or potentially eliminates, items that are outside the boundaries drawn. As a principle of public purchasing, however, a specification should be written to encourage, not discourage, competition consistent with seeking overall economy for the purpose intended.⁸

To this end, SLGP encourages the use of performance specifications. The performance (or functional) type of specification is less concerned about design, dimensions, and materials and more concerned with what the product can do, how well it performs, and what it costs. According to SLGP,

Performance purchasing is results-oriented in terms of function and cost. In contrast to the design approach, performance specifications afford the manufacturer or bidder sizable latitude in how to accomplish the end purpose.⁹

It is, therefore, in consonance with the public purchasing goal of encouraging competition that a public entity should encourage the use of performance specifications.

The City of San Jose needs to better emphasize performance specifications. Our audit disclosed one instance in which the City could have benefited by using performance specifications. This contract was for the November 1990 purchase of the electronic readerboard from Daktronics, Inc., for the Department of Convention and Cultural Facilities in the amount of \$119,833.

The initial specifications that Purchasing and the Department of Convention and Cultural Facilities prepared called for a “Glow-Cube Display.” However, “Glow-Cube Display” is a registered trademark and only the trademark owner could supply that type of display. In a letter to the City, a prospective vendor complained

⁸ SLGP, page 43.

⁹ SLGP, page 45.

about the “tight” specifications. According to the complainant, the restrictive criteria effectively resulted in “creating a single source supplier.” After receiving the complaint, the City decided to withdraw the original specifications and reissue them with less restrictive wording on the specifications. These circumstances resulted not only in delays and wasted staff time but also in a possible decrease in vendor confidence and goodwill for the City.

Had Purchasing required performance specifications or a combination of performance and design-type specifications in the first place, the City might have avoided the problems that arose in the purchase of the electronic readerboard. In our opinion, based on the City’s experience in the purchase of the electronic readerboard and the recommendation of authoritative purchasing standards, the City should encourage the use of performance specifications.

Design specifications are appropriate in certain situations. The Purchasing staff should decide whether design or performance specifications are appropriate in a particular case by considering factors such as time, resources, and requirements. If only one product will meet an intended need, the Purchasing Manager should require written justification and document approval of this.

According to SLGP,

The brand name specification or a detailed specification which is written to have the effect of limiting the bidding to a single product are the most restrictive kinds of specifications. Their use should not be permitted unless only one product will meet an intended need, and the chief purchasing official has made a prior written determination to this effect. And even where product competition has to be denied, price competition should be solicited to the extent possible.¹⁰

¹⁰ SLGP, page 44.

Brand-name-or-equal specifications invite product and price competition across the marketplace, and they have a legitimate place in public purchasing although they tend to be overdone. Only where the time and resources necessary to develop another kind of specification are not available or cannot be justified, or where simple practicality dictates, should the brand-name-or-equal specification be used and the savings in time directed to more complex specification efforts in other product areas.¹¹

Some may argue that the using department, which provides the technical data for the specifications, would not have the expertise to prepare performance specifications. In our opinion, such expertise should reside in Purchasing. The Purchasing staff can work jointly with the using department so that the resulting specifications are performance oriented. According to SLGP,

The duty of public purchasing to promote both product and price competition requires that purchase specifications be as non-restrictive as practicable, consistent with satisfying legitimate needs. This duty remains the same when specifications are prepared by using agencies or by independent architects and engineers.¹²

Thus, Purchasing should have the final responsibility for the competitiveness and suitability of purchase specifications. Under these guidelines, the using department would continue to supply the technical data and prepare the first draft of the specifications. Purchasing's responsibility then would be to help rewrite the specifications as needed to make them performance oriented rather than design oriented when appropriate. If the using department needs to refer to a brand name to describe a desired product, Purchasing should require that the specifications also cite other equivalent brands, if possible, and to append the words "or equal" after the brand names. Additionally, unless the brand reference adequately conveys the

¹¹ SLGP, page 44.

¹² SLGP, page 48.

characteristics Purchasing is seeking, Purchasing should specify any particular design or functional characteristics it requires.

According to the Director of General Services, the bid specification issues raised in the City Auditor's report are due to a lack of centralized control over specification writing. The Director stated:

The role of the departments is very clear. They have the expertise in the department and the knowledge to provide definitive input into the specification writing process, but it is also clear that the control of that process ought to be within the Purchasing Division. In this regard, there should be a position established in the Purchasing Division that is devoted solely to the writing of specifications so that specifications that are developed are consistent with State law, City ordinances, and the need to insure competitive processes that will benefit the City of San Jose.

This will not result in the loss of department input into the system, but rather will serve to avoid some of the problems that have occurred in the past in the formal bidding process.

In our opinion, the need for and use of a Specification Specialist in Purchasing should be addressed in the City Council 1992-93 Operating Budget deliberations.

Discretion Over Bid Options

“Bid options” or “optional items” are features that may be adapted to the basic equipment or other products to enhance performance or capacity. Bid options may be needed under certain circumstances or may represent only luxury accessories. Bid options are important cost considerations because they can affect significantly the total price of the merchandise and, consequently, the ranking of the bidders.

The book State and Local Government Purchasing states that the purchasing entity should not wait until it opens the bids or evaluates them for award to determine which optional items it will definitely purchase and which ones it will purchase only if funds are available. Otherwise, according to SLGP, provisions for optional items “can be manipulated to exercise favoritism.”¹³

Our audit disclosed one instance in which the City delayed its decision concerning optional items, resulting in the appearance of favoritism in the selection of the winning bid. It should be noted that our review did not disclose any evidence of actual impropriety on the part of any City staff.¹⁴ The purchasing contract was the June 1990 purchase of a hazardous materials van for the Fire Department. Two prospective vendors submitted their bids for this contract, showing their prices for the base unit as well as the optional items listed in the specifications. The winning bidder was John F. Russo, Inc., with the amount of \$321,455.

Although the winning bidder’s base bid was lower than the unsuccessful bidder’s base bid, the winning bidder’s total price (base unit plus options) was higher. The original bid tabulation sheet showed the base unit and eight options. In deciding on the final package to purchase, the Fire Department excluded two options from the bid tabulation sheet for both bidders and one other option from the winning vendor’s bid to determine the effective bid total for each bidder. Because the City excluded some of the optional items in computing the effective bid price, the winning bidder ended up with the lower priced bid. Had the City included all the option

¹³ SLGP, page 48.

¹⁴ We are using the purchase of the hazardous material van to illustrate the manner of handling optional items, not to question the award to the selected bidder. The City made the award not only on the basis of the total price but also on the responsiveness of the bidders.

prices in the effective bid prices, the bid price of the winning vendor would have exceeded the bid price of the unsuccessful vendor.

In discussing this issue with the Purchasing staff, we have learned that the City's practice has been for the using department to decide which options the department is definitely going to purchase and which ones the department is going to purchase depending on the availability of funds and the price of the options. The effective bid price then becomes the base unit price plus the prices of the options that the City has decided to purchase.

In our opinion, the controls to prevent or detect manipulation of the bid prices through optional items were inadequate in the purchase of the hazardous materials van. The Fire Department did not initially prioritize the options to Purchasing to indicate which options the City should first exclude if funds were insufficient. Furthermore, the bid tabulation sheet did not show the reason for the exclusion of any of the options. As a result, the selection of the winning bid in the purchase of the hazardous materials van did not appear to be entirely objective.

To ensure fairness in the bid evaluation and to preclude any actual or perceived manipulation of bid prices by including or excluding optional items, Purchasing should require that the using department spell out, prior to sending out the bid invitations, how the City is to treat optional items in the bid evaluation and should require the Purchasing staff to determine the effective bid price in accordance with the priorities established. Purchasing should also explain any variance from the stated procedure on the bid tabulation sheet.

**City Departments Can Evaluate Bids On The Basis
Of Criteria Not Spelled Out In The Bid Specifications**

The Model Procurement Code for State and Local Governments, published by the American Bar Association, recommends the following regarding evaluation criteria:

*The Invitation for Bids shall set forth the evaluation criteria to be used. No criteria may be used in bid evaluation that are not set forth in the Invitation for Bids.*¹⁵

The purpose of including the evaluation criteria in the bid invitation is to focus the competition not only on similarities and equivalencies but also on differences and superiorities. Knowing the evaluation criteria in advance, the prospective vendor can better prepare or manufacture his or her product not only to meet the specifications but also to demonstrate the product's superiority over its competitors.

Our audit disclosed one instance in which the City evaluated the result of a demonstration relating to a bid on the basis of criteria that were not spelled out in the bid specifications. The purchasing contract was the November 1990 purchase of the electronic readerboard from Daktronics, Inc., for the Department of Convention and Cultural Facilities (DCCF) in the amount of \$119,833.

The specifications that accompanied the bid invitation provided the product description and gave the dimensions and the types of acceptable materials and construction. However, they did not mention any performance evaluation criteria. After the bids were opened, Purchasing and DCCF determined that two of the bidders did not meet the bid specifications. One of the bidders that the City considered nonresponsive requested the opportunity to demonstrate its sign. Thus,

¹⁵ Model Procurement Code for State and Local Governments, page 25.

the City invited the nonresponsive bidder and the remaining responsive bidder to demonstrate their respective products.

Accordingly, the two bidders demonstrated their products to the Purchasing and DCCF staffs. In evaluating the bids based on the product demonstrations, the DCCF staff determined the criteria for selecting the vendor that best met the specifications. A memorandum from the Director of Convention and Cultural Facilities, dated November 1, 1990, described the evaluation criteria. These criteria included (1) visibility, (2) computer systems, (3) training, (4) service, and (5) product capability. In our opinion, the evaluation criteria themselves were appropriate. However, the original bid specifications were design specifications (with brand-name-or-equal designation) that did not mention the performance qualities that these subsequent evaluation criteria represented. The bid specifications, as a basic mark of fairness to the bidders, should have stated the performance evaluation criteria in the first place so that the evaluation criteria were clear to all the bidders from the start.

In the future, to preclude any actual or perceived lack of impartiality in the evaluation of bids, Purchasing should require that all purchase specifications clearly state the bid evaluation criteria and should ascertain that the using department and the Purchasing staff use, during the bid evaluation, only the criteria described in the purchase specifications. Additionally, unless the brand reference adequately conveys the performance characteristics Purchasing is seeking, Purchasing should specify any particular design or functional characteristics it requires.

No Bidders Lists Or Performance Files

One of the fundamentals of public contracting is that public business should be open for competition. However, the public entity cannot simply wait for competition to occur spontaneously. Many public entities rely on public notices to encourage competition. According to SLGP, such public notices contribute to the openness of the purchasing process but are “not highly useful in generating competition.”¹⁶ Generating competition has to be a purposeful activity. A more effective way to actively generate competition is to establish and maintain a bidders list and to use the list when soliciting bidders for government business.

Our review disclosed that the City has not established an effective and efficient bidders list. In organizing a formal bid, Purchasing prepares a list of vendors to whom Purchasing will send the bid invitations. The buyer develops the list for each formal bid by using reference books (e.g., Thomas’ Register of American Manufacturers), vendor questionnaires, prior solicitation, and suggestions from the requisitioning department. In developing the list of vendors to solicit for a specific bid, Purchasing does not use a centralized database (i.e., a formal bidders list) that categorizes vendors according to goods or services they can furnish. Instead, Purchasing creates an ad hoc vendor list for each purchase.

Relying on an ad hoc vendor list has two disadvantages. First, the time limitations for developing the vendor list may preclude “pre-qualification”. Pre-qualification allows the purchasing office to pre-determine the performance capabilities and qualifications of the vendors on the list.¹⁷ Second, the lack of a

¹⁶ SLGP, page 53.

¹⁷ SLGP, page 54.

database of vendor history may preclude the purchasing office's assurance that it will exclude from consideration for contracts vendors who have not performed satisfactorily in previous dealings with the City.

In contrast, with a centralized database serving as a source for vendors lists for specific bids, the City would benefit in the following ways:

1. Purchasing can build an effective bidders list using its accumulated experience in dealing with vendors. With such a database, the City can generate the maximum reasonable competition for City business and yet avoid unproductive and wasteful solicitations;
2. The database serves as a basis for pre-qualifying vendors and evaluating their performance; and
3. The database provides a ready source of potential vendors in circumstances requiring quick procurement. In this regard, Purchasing can use the centralized database not only for purchases requiring a formal bid but also for negotiated purchases and other types of non-bid purchases.

The benefit of a formal bidders list in promoting vendor competition is illustrated in one of the formal bids in our audit sample. This is the June 1990 purchase of seal coat aggregate in the amount of \$409,354. Purchasing solicited only one vendor for this formal bid. We discussed this matter with the Purchasing staff to find out if it was possible to improve the competition for this commodity. During our review, we learned that Purchasing was able to find four other potential vendors to solicit. As a result, when Purchasing processed the formal bid for seal coat aggregate in 1991, Purchasing sent the bid invitation to five vendors instead of only one. Two bidders responded and the bid was awarded to the lowest bidder for \$366,788 per purchase order dated July 18, 1991. A formal bidders list would have

been useful in alerting Purchasing to the availability of the four other vendors in 1990.

The example above illustrates the usefulness of a formal bidders list. In order to effectively generate vendor competition, Purchasing should develop and maintain a formal bidders list. The list should be in the form of a centralized database of prospective vendors. Purchasing can use this list to pre-qualify vendors, evaluate their performance, and draw up a list of vendors when soliciting specific formal bids.

It should be noted that the City Auditor's Office has for a number of years stressed the importance of Purchasing developing a commodity database and a system for monitoring vendor performance. According to the Director of General Services:

This has not taken place primarily because, in the design of the FMS system, the bidder's module, which is a part of the automated purchasing system, has not been implemented. This puts the Purchasing Division at a distinct disadvantage in that the volume of work is such that they cannot today develop statistical data upon which they can make necessary decisions.

The lack of the bidder's module is adversely affecting their ability to implement a dynamic minority program. It also impacts adversely their ability to monitor vendor performance. Finally, and most importantly, it affects their ability to develop statistical data in which to make rational decisions.

It is absolutely essential that this module be implemented as soon as possible. If it is not possible to implement the bidder's module in the present FMS system . . . a stand-alone system [should] be placed at Purchasing so that this program can be developed.

Bid Tabulations Not Always Complete Or Verified

A bid tabulation is a record that lists the bidders who respond to a specific solicitation and summarizes their bids, showing items offered, prices, deliveries, and other pertinent information.¹⁸ The purpose of a bid tabulation is to assist the Purchasing staff and management in comparing and evaluating the bids and documenting the evaluation process. The City's written purchasing procedures require the Purchasing staff to prepare a bid tabulation at the opening of bids.

Our review of bid tabulation sheets indicated that some bid tabulations were incomplete or did not show evidence of verification or approval. In reviewing 13 formal bid files at Purchasing, we found the following:

- Four had bid tabulation sheets that did not show some pertinent bid information presented in the bids and/or did not agree with the Report on Bids memorandum to the City Council or the prices that the bidders submitted;
- Three of the bid tabulation sheets were not totaled to indicate the effective bid price; and
- None of the 13 bid tabulation sheets had evidence of an independent review to verify that the bid tabulation sheets agreed with the bid documents and the Report on Bids memorandum to the City Council.

Appendix D summarizes the results of our review of bid tabulation sheets.

It is the buyer's responsibility to ensure that the bid tabulation sheet contains all the required information. However, as discussed above, some bid tabulations

¹⁸ SLGP, page 227.

were incomplete or did not show evidence of verification or approval. Completeness in a bid tabulation is essential to provide the City with documentary evidence of the bid evaluation should a subsequent dispute arise. So that Purchasing can ascertain that bid tabulations are accurate and complete, Purchasing should establish a system to monitor compliance with its bid tabulation procedure, including the rules for accepting bid changes after the City opens the bids.

Additional Written Procedures And Guidelines Are Needed

Various City departments, offices, and agencies are involved in the City's formal bidding process. The City needs adequate written procedures in order to ensure that formal bids are handled consistently throughout the City. Our audit disclosed that the City will be able to conduct its purchasing activities more effectively if the City establishes guidelines and standard procedures for dealing with the following matters: (1) preparing bid specifications, (2) evaluating exceptions to bid specifications, (3) assessing whether a bidder is responsive and responsible, (4) inquiring into reasons for lack of competition, and (5) bidding open purchase orders.

1. *Preparing bid specifications*

The City does not have a standard format for purchase bid specifications. Some of the specifications that we reviewed included features that others did not have. So that writing specifications is efficient and the specifications produced are complete and consistent, the City should require the use of a standard outline or format for specifications with instructions to the bidder about what information it requires and an approval sheet from the departments. Such a standard outline should include the items listed in Appendix E. Appendix F shows an example of a specification approval sheet.

2. Evaluating exceptions to bid specifications

The City does not have guidelines for evaluating exceptions to bid specifications. Purchasing should determine the criteria for what the City will consider as minor or major exceptions to the bid specifications. These should then be part of the evaluation criteria included in the bid specifications.

3. Assessing whether a bidder is responsive and responsible

The City does not have guidelines for assessing whether a bidder is responsive and responsible. A responsive bidder is a bidder whose bid conforms in all material respects to the terms and conditions, the specifications, and other requirements of the bid invitation.¹⁹ A responsible bidder is a bidder who has the capability in all respects to perform in full the contract requirements and has the integrity and reliability that will assure good faith performance. Municipal Code Section 4.12.115 states, “*A responsible bidder is a vendor with the capability in all respects, to perform the purchasing contract completely.*” With regard to responsiveness, absolute or precise conformity is not imperative; therefore, guidelines are needed to help Purchasing and the using department determine the materiality of items of nonconformance in the bid submittals.²⁰ With regard to responsibility, guidelines are needed to prescribe the acceptable method or methods of ascertaining the bidder’s capability to perform as required. Municipal Code Section 4.12.120 states, “*Where formal bidding is utilized, contracts shall be awarded by the city council to the lowest responsible bidder meeting specifications, unless the council rejects all bids.*”

¹⁹ SLGP, page 225.

²⁰ According to SLGP (page 225), the rule is that conformity in material respects, i.e., substantial compliance, suffices. This protects the public from being denied bona fide competition for reasons that are inconsequential.

During the period covered by our review, the City awarded 12 of 39 formal bids to bidders who did not submit the lowest priced bid.²¹ The City considered these lowest priced bids as being nonresponsive. Of these 12 rejected lowest priced bids, 2 were in our audit sample. The first of these rejected lowest priced bids was the readerboard formal bid discussed on Page 29 in this report. In this case, the City, in our opinion, used a specification that essentially rendered only one bidder responsive. The successful bidder's price was \$119,832.57, and the lowest priced bid was \$90,495.13, a difference of \$29,337.44.

The second rejected lowest priced bid in our sample was the purchase of 111 police sedans. In this case, the City declared the lowest bidders, the Ford dealers, nonresponsive because their bids lacked two features--fuel injection and 6-way power bucket seats. The City considered the Chevrolet dealers responsive. As stated in the Report on Bids memorandum to City Council, dated March 14, 1990, the two features--fuel injection and 6-way power bucket seats--were placed in the bid specifications “*. . . due to the importance these features have in reducing maintenance and driveability problems and driver stress related back injuries.*” The bucket seat configuration also provided the necessary space for installing standard communications and police equipment according to the memorandum. However, Purchasing had no documentation in its bid file to support this justification.

The successful bidder, a Chevrolet dealer, bid \$1,623,231.95, which was \$191,901.51 higher than the lowest Ford bidder. It should be noted that, like the unsuccessful bidder, the successful bidder also did not respond to all of the items in the bid specifications. For example, the successful bidder did not include in its bid the radio suppression grounding straps or driver door locks that were in the bid specifications. In evaluating the bids for the police sedans, the City considered these bid exceptions as being minor. However, the City considered the nonresponsive bidders' bid exceptions (fuel injection and 6-way power bucket seats) to be major enough to render the bidders nonresponsive. In our opinion, the purchase of the police sedans illustrates the need for Purchasing and the using department to determine what constitutes minor or major bid exceptions and to include this in the bid specification information.

²¹ Appendix G lists the non-low bid awards. It should be noted that our audit did not disclose any evidence that any of the non-low bid awards were inappropriate.

It is critical that the City properly evaluate each bidder's responsiveness and responsibility according to standard guidelines and adequately support a decision to award purchases to other than the lowest bidder. In our opinion, the Purchasing Manager should review and approve the evaluation and award decision in these instances.

4. *Inquiring into reasons for lack of competition*

During the period of our review, we noted four formal bids in which the City received only one bid. These four formal bids are for the following purchases: (1) seal coat aggregate for \$409,354; (2) fourteen 3-wheel motor scooters for \$142,973; (3) seven pick-up trucks for \$103,181; and (4) three 4-door sedans for \$39,974. The City accepted the sole bids for these purchases without documenting the reason only one bidder responded for each formal bid. In our opinion, Purchasing should have evaluated and documented the results in these four formal bids to determine if resolicitation was appropriate. According to SLGP, "*Where only a single acceptable bid or proposal is received, the purchasing office should inquire as to the reasons for the lack of competition. . . . The public is entitled to available competition, and if reasonable competition can be expected by resolicitation, that course can be taken.*"²² Of course, if Purchasing determines that the single bid is advantageous to the City, it would be appropriate to accept it. However, in our opinion, Purchasing should at least investigate and document the reason for the lack of competition. Purchasing should, therefore, establish guidelines for evaluating the adequacy of competition when the City receives only one bid.

5. *Bidding open purchase orders*

The City does not have guidelines for the handling of open purchase orders that are put out to bid. Municipal Code Section 4.12.146.D states, "*Formal bidding is not required in order to establish an open purchase order for supplies, materials or equipment regardless of its total dollar amount.*" However, the City formally bids some open purchase orders. Furthermore, the open purchase orders that the City has put out to bid have not been consistently reported to the City Council. For example, some of the formally bid open purchase orders were presented to the City Council in a

²² SLGP, page 58.

Report on Bids memorandum similar to the other formal bids, while others were not. So that Purchasing and the using departments handle open purchase orders consistently, the City should establish guidelines for determining which open purchase orders should be formally bid, the procedures for processing these formal bids, and how the formally bid open purchase orders are to be reported to the City Council.

The City's Formal Bidding Process Needs Additional Documentation

In order to avoid possible legal challenges and unnecessary time delays, it is important that state and local governments adequately document their formal bidding process. Our review of the City of San Jose's formal bidding process revealed that documentation was lacking with regard to (1) buyer reviews of bid specifications, (2) analyses of sole vendor bid submittals, (3) management information on formal bidding activity, and (4) staff reviews of the Report on Bids memorandum.

1. Buyer reviews of bid specifications

Our audit revealed that the Purchasing staff does not document its reviews of the bid specifications. According to authoritative purchasing standards, sound procurement management requires that purchase specifications be centrally controlled so that the specifications are prepared consistently and appropriately.²³ If the using department prepares a specification, Purchasing should review it for correctness, competitiveness, and suitability. The Purchasing staff member assigned to the purchase has the final responsibility over the specifications. Purchasing could include the documentation of the review in the checklist of review items for the formal bids, showing approval signatures. By using a checklist and documented approvals, Purchasing can be assured of consistent reviews of bid specifications.

2. Analyses of sole vendor bid submittals

The purpose of a bid price analysis or comparison is to determine whether the price submitted by the sole bidder is reasonable and should be accepted or whether it is excessive and should be rejected and the purchase rebid. According to Municipal Code Section 4.12.090, if the City Council finds that the amount of the bids is excessive, it may elect to have the items purchased at lower prices. Our review revealed that the City did not document or require analyses of bid prices when only one bidder responded to a bid solicitation. Consequently, it was not possible to ascertain whether

²³ SLGP, page 43.

a bid award to a sole bidder was appropriate because of the lack of documentation supporting the reasonableness of the bid price. In the future, Purchasing should document its bid price analyses by describing its activities and sources when verifying the reasonableness of the bid prices.

3. Management information on formal bidding activity

Municipal Code Section 4.12.120 requires the City Council to approve formal bids administered by Purchasing. Although Purchasing reports all purchases exceeding \$20,000 to the City Council, it does not identify which purchases were formally bid in the weekly and quarterly reports. Furthermore, our review disclosed that the City does not have an efficient method for summarizing its formal bidding activity. For example, when we needed to determine the formal bids that the City processed during the period under review, the information was not readily available at Purchasing. We had to develop the information by listing the purchases over \$20,000 from the City Council synopses and reviewing files at Purchasing to identify the formal bids. So that the City Council can identify the purchases over \$20,000 that were formally bid from the ones that were not, we recommend that Purchasing include data on formal bid activity in the City's Financial Management System (FMS) and differentiate in the City Council reports the purchases that were formally bid.

4. Staff reviews of the Report on Bids memorandum

Our audit revealed that the Purchasing Manager and his staff do not document their review of the bid evaluation and the Report on Bids memorandum to the City Council. The department and Purchasing conduct the bid evaluation when they review the bids for adherence to the specifications. The buyer then prepares the Report on Bids memorandum based on the bid evaluations, and the Purchasing Manager and the department staff analyst review it before submitting it to the Director of General Services for approval. The documentation of the Purchasing staff's review is essential to ensure that the staff properly review the bid evaluation and correct all errors or omissions in the Report on Bids memorandum. During our review, we noted errors in one memorandum and omissions in another. The first is the Report on Bids memorandum for the purchase of seal coat aggregate. This memorandum contained errors in

the number of vendors solicited and in the dollar amount of the award.²⁴ The second is the Report on Bids memorandum for the purchase of 111 police sedans. This memorandum omitted the budget reference for the fleet additions, although it did show the budget reference for the fleet replacements. To ensure that the Purchasing staff properly reviews the bid evaluation and the Report on Bids memorandum before submitting it to the Director of General Services for approval, we recommend that Purchasing document and date its reviews with a sign-off sheet. Appendix H shows an example of such a sign-off sheet.

The Filing Of Bid Documents Can Be Better Organized

During our review of the bid files at Purchasing, we noted that Purchasing can better organize the filing of the bid documents. We noted the following regarding the filing system:

- The numbering of bid files was not consistent. Inconsistent file numbering hinders the efficient tracking of bid files. For example, to locate a bid file, one must first find out the successful bidder and/or the description of the items purchased;
- The bid file contents were not indexed or arranged in a consistent order. To locate a specific document, we had to search through all the documents in the file; and
- The files did not have a checklist to indicate the types of documents that each file should contain. With such a checklist, Purchasing can easily determine if important documents are missing from the file.

In our opinion, Purchasing should develop and implement an effective filing system for its bid files, including (1) a consistent numbering system, (2) an indexed and consistent arrangement of bid file contents, and (3) a checklist indicating the types of documents that each file should contain.

²⁴ The purchase order, however, did show the correct amount. Therefore, no adjustment is needed for this transaction.

Additionally, we noted during our review that Purchasing discarded an important document relating to the receiving and opening of bids. This document is the bid envelope. When Purchasing receives a bid, the staff stamps the date and time of receipt on the envelope. The staff also stamps the date and time on the bid submittal when the buyer opens it. The recording of the dates and times of receipt and opening of bids is critical in determining the timeliness of bid submission and opening. Thus, the bid envelope records events whose timeliness the City may need to substantiate should a subsequent dispute regarding the bidding process arise. In our opinion, Purchasing should retain the bid envelope and file it with the other bid documents.

CONCLUSION

A formal bidding process for state and local governments should be open and fair, encourage competition, and provide the purchasing entity with the best product at the lowest possible price. Our review revealed that the City can improve its formal bidding process. By formalizing and standardizing the preparation and evaluation of bid specifications and submittals and vendor solicitations and performance, improving the tabulation of bids, developing written procedures and guidelines, requiring additional documentation, and better organizing formal bid files, the City of San Jose will have greater assurance that its bidding process is open, fair, competitive, and economical.

RECOMMENDATIONS

We recommend that General Services Department/Purchasing Division take the following actions:

Recommendation #9

Establish a policy requiring purchase specifications to be as nonrestrictive and performance oriented as practicable and require departments to submit written justifications for any restrictive purchase specifications. In order to facilitate this recommendation, Purchasing should request the funding and authorization for a Specification Specialist position in 1992-93. (Priority 3)

Recommendation #10

Require that the using department specify how the City is to treat optional items in the bid evaluation and require the Purchasing staff to determine the effective bid price in accordance with the priorities established. Purchasing should also explain any variance from the stated procedure in the bid tabulation sheet. (Priority 2)

Recommendation #11

Require that all purchase specifications clearly state the bid evaluation criteria and ascertain that the staff use only the evaluation criteria included in the purchase specifications. (Priority 2)

Recommendation #12

Develop and maintain a formal bidders list in the form of a centralized database of prospective vendors that provides a process for pre-qualifying vendors and evaluating their performance. This recommendation is contingent upon the administration implementing the Financial Management System bidder's module. Absent such implementation, Purchasing should request funding for a stand-alone purchasing system in 1992-93. (Priority 2)

Recommendation #13

Establish a system to monitor compliance with Purchasing's bid tabulation procedure, including the rules and controls for accepting bid changes after the City opens the bids. (Priority 3)

Recommendation #14

Establish guidelines and standard procedures to assist the City departments, offices, and agencies in (1) preparing bid specifications, (2) evaluating exceptions to bid specifications, (3) assessing whether a bidder is responsive and responsible, (4) inquiring into reasons for lack of competition, and (5) bidding open purchase orders. (Priority 3)

Recommendation #15

Document (1) buyer reviews of bid specifications with approval signatures, (2) analyses or comparisons of sole vendor bid submittals with a description of activities and sources when verifying the reasonableness of the bid prices, (3) the City's formal bidding activity in reports to the City Council and in the Financial Management System, and (4) staff reviews of the bid documentation and the Report on Bids memorandum with an approval sign-off sheet.
(Priority 3)

Recommendation #16

Develop and implement an effective filing system for Purchasing's bid files, including (1) a consistent numbering system, (2) an indexed and consistent arrangement of bid file contents, and (3) a checklist indicating the types of documents each file should contain. (Priority 3)

Recommendation #17

Retain the bid envelope, which shows the dates and times of bid receipt and opening, and file it with the other bid documents. (Priority 2)

Recommendations Requiring Budget Action

Of the preceding Recommendations, #9 and #12 cannot be implemented absent additional funding. Accordingly, subject to City Council approval of these Recommendations, the City Manager should include in the City Manager's Proposed Operating Budget for 1992-93 an amount sufficient to implement Recommendations #9 and #12.